

## INTRODUCTION

prosecutors and the courts. The investigation of fraud, because it deals with the individual rights of others, must be conducted only with adequate cause or predication.

~~Predication is the totality of circumstances that would lead a reasonable, professionally trained, and prudent individual to believe a fraud has occurred, is occurring, and/or will occur.~~ Predication is the basis upon which an examination is commenced. Fraud examinations should not be conducted without proper predication.

### Fraud Theory Approach

*Each fraud examination begins with the proposition that all cases will end in litigation.* To solve a fraud without complete evidence, the examiner must make certain assumptions. This is not unlike the scientist who postulates a theory based on observation and then tests it. In the case of complex fraud, fraud theory is almost indispensable. Fraud theory begins with the assumption, based on the known facts, of what might have occurred. Then that assumption is tested to determine whether it is provable. The fraud theory approach involves the following steps, in the order of their occurrence:

- Analyze available data
- Create a hypothesis
- Test the hypothesis
- Refine and amend the hypothesis

A case study on internal fraud that is based on an actual incident, and one that is common in the commercial and governmental environment, illustrates the concepts involved in the fraud examination process. The names and certain other facts have been changed for purposes of illustration.

#### LINDA REED COLLINS CASE STUDY

*Linda Reed Collins is purchasing manager for Bailey Books Incorporated in St. Augustine, Florida. Bailey, with \$226 million in annual sales, is one of the country's leading producers of textbooks for the college and university market as well as technical manuals for the medical and dental professions.*

*Bailey's headquarters consists of 126 employees, plus numerous sales personnel in the field. Because of the competitive nature of the textbook business, their profit margins are quite thin. Bailey's purchases average about*